

DOW THEORY LETTERS INC.

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Letter 434

THE MARKET: The moon shot was fantastic, and somehow I connect it with what I wrote last week about encounter groups in California. Man seems to be way ahead in the science of space and space technology, way ahead of his understanding of his own emotions. There is nothing unconsciously threatening about an incredible trip to the moon. But there is very much threatening about confronting one's own inner fears. Man's scientific efforts go forward, even while most men lead unsatisfactory lives of inner frustration. The disparity between man's knowledge of the outer world and his knowledge of his inner world was never greater in all history.

But this is a market Letter, and perhaps I should tell a different kind of story. I arrived at my office at 6:45 A.M. last Tuesday, and I sat here alone studying a chart of the Averages. I often get here early, and I find that the misty California sunrise and the lack of distraction allow for thought. What interests me, what occupies my own mind is what I write about. Dow Theory Letters is the output of one man, and I depend on my own interest to provide food for these reports. If a subject interests me, I hope it will interest my subscribers. What I watch I would like my subscribers to watch. If I think it is unimportant or uninteresting I can't and don't write about it. It seems to me that any other policy is fake, and that, in a nutshell, is how and what these Letters are all about.

At 7:15 I received a phone call. A man's voice opens the conversation. "Hello, I'm calling from Los Angeles. Is this Mr. Russell?"

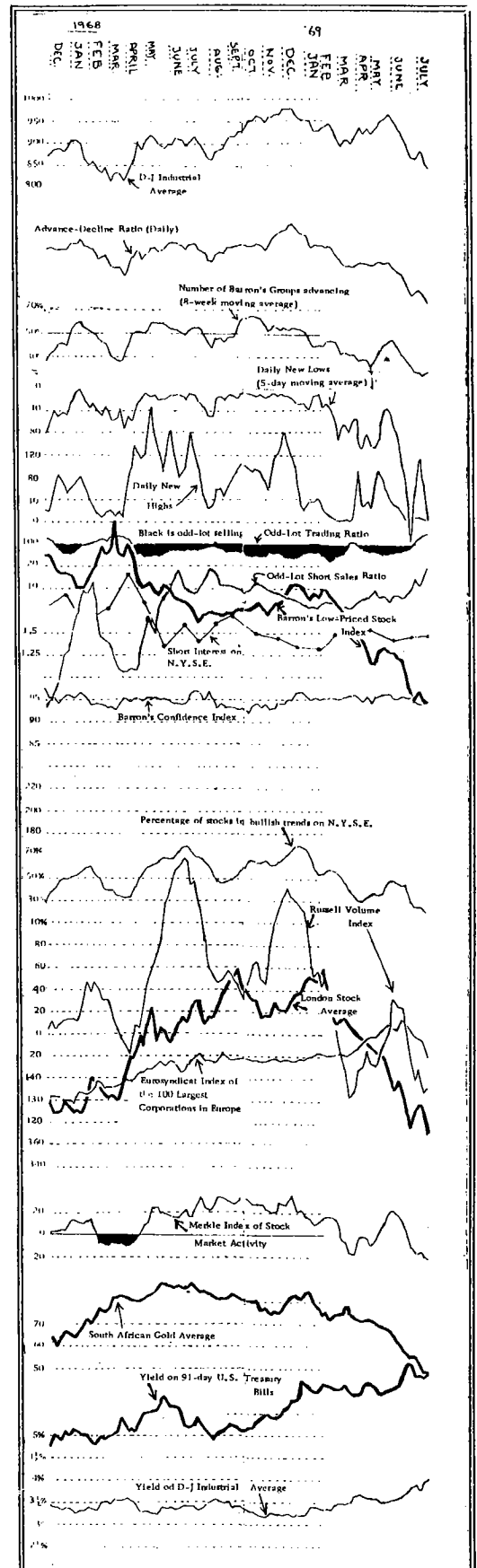
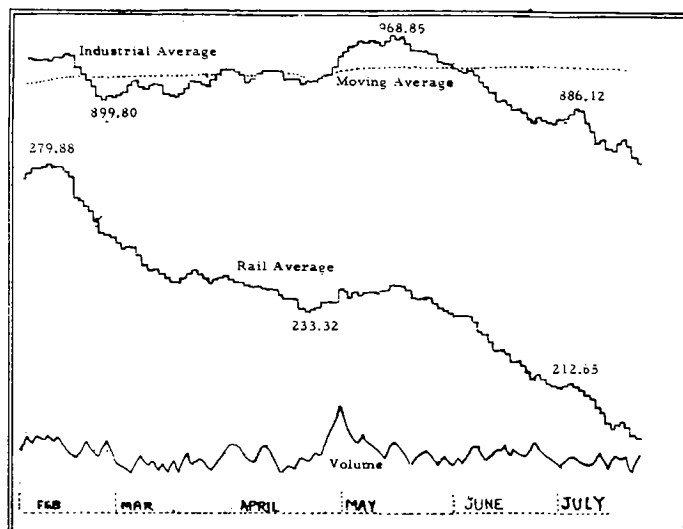
"It is."

"I was reading your report at a friend's house. I want to subscribe, and I'll be sending you an order in the mail. But first I'd like to ask you a question."

"All right, but I can't promise to answer it, and I can't promise that I'll want to answer it."

"Well, here it is. What do you think of this rally? Do you think it's going to last?"

I immediately know I am talking to an amateur speculator who is locked in with losses. He wants me to tell him that everything is going to be pleasant, and that he is going to recoup most of his losses. I answer: "You've just asked me the commonest and most impossible question in the business. I can tell you what looks



Page 2 good about the rally, and I can tell you what looks bad about the rally. But I wouldn't begin to try to tell you how far the rally is going or how long it will last or what stocks will or will not participate. I can tell you that this is a primary bear market, and that I think the market will be considerably lower a year from now. I can tell you that there is nothing in the current picture that looks like the termination of the primary bear trend.

"Trying to beat the short-term is, in my opinion, a hopeless procedure, and it constitutes the road to ruin. If you want to know whether the rally is going to be a good one because you want to jump in, you are trading against the trend, and you will probably lose your shirt in due time. If you are asking because you are caught with a collapsing portfolio, then you should find why you got caught so you don't repeat your mistake. Once you arrive at a conclusion as to the long-term trend of the market, get on the right side, forget about short-term and scalping operations and get some sleep and peace of mind."

"Oh," says the caller, "and I can feel his frustration and disappointment. "Well, thank you very much, Mr. Russell."

I can tell that this man is a loser. I sense that he does not want to study the market, he does not want to find out why he is sustaining a loss of probably a major part of his capital. He wants advice, and I suppose the best advice for him is that he should stay off Wall Street entirely. He wants something for nothing, profits without work or study, a gift from Lady Luck. It won't happen, and if by some chance it happens once it will not happen again.

To turn to the market, I just finished charting the weekly high-low and closings for the D-J Industrials, Rails and Utilities for the period of 1966 to date. Often, when you make your own charts you catch things which you might not notice when you simply look at a chart which someone else has sweated over (see chart marked "A").

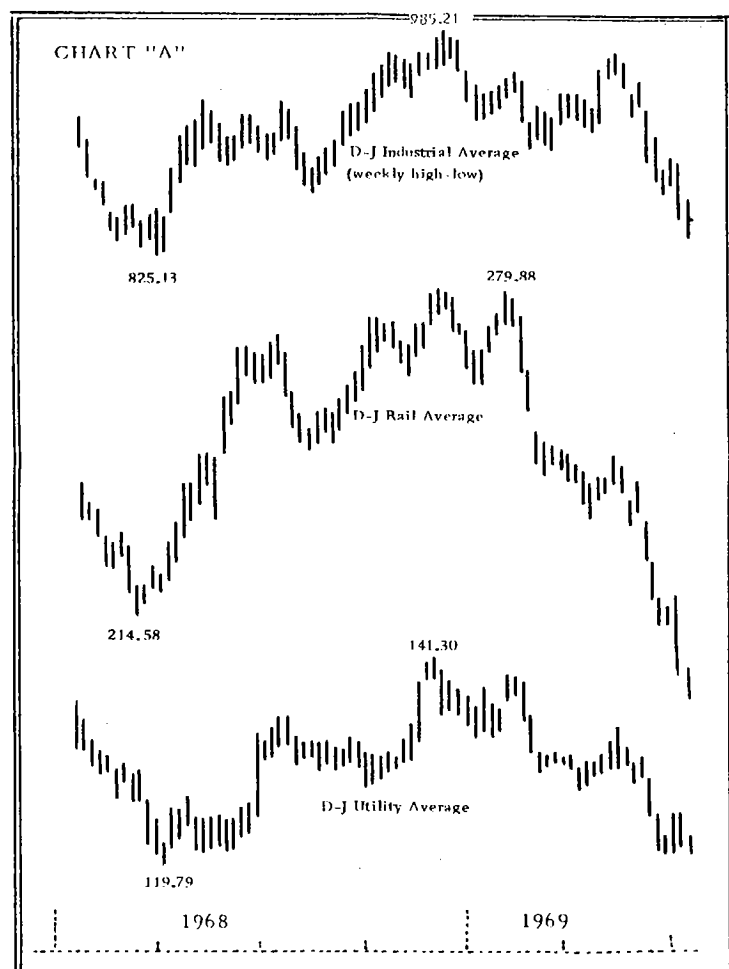
One phenomenon which struck me was the number of times that the Utility Average has bottomed out in 118-120 area. The D-J Utility Average has fluctuated within a high of 152.39 (1966 high) and 118.96 (1966 low) for the past four years. The low for the Utility Average in 1966 was 118.96, the low in 1967 was 120.97, the 1968 low was 119.79 and the 1969 low was 120.94. The Utility Average is currently within a few points of the bottom range of the past four years.

It occurs to me that any Utility break below the 1966 low of 118.96 would be most significant, since this would mean that one of the bluest of the blue-chip Averages had slid below a base area which has held for the past four years. I draw attention to the Utilities because interestingly enough this is the Average which, on further weakness, could be the first of the three Dow Averages to penetrate its bear market lows of 1966.

Therefore, may I suggest that subscribers watch the future action of the Utility Average. A drop of a few more points would result in a penetration of the 1966 low of 118.96. As a rule, a penetration of one Average during a primary movement results in confirmations by the other Averages. I would consider a drop by Utilities below 118.96 to be a most bearish development.

As far as the Industrials and Rails are concerned, this is what I see. The Rail Average has dropped below its important 1968 low of 214.58. The comparable 1968 low for Industrials is 825.13. So far, Industrials have not confirmed the Rails in penetrating their 1968 low.

Therefore, for near-term purposes we have two important points on two of the Averages to watch. The first is the extremely important 1968 Industrial low of 825.13. The second is the 1966 Utility low of 118.96. Actually, the 118.96 Utility low is the lowest level Utilities have reached since 1962, so that if the Utility Average breaks 118.96 it will have dropped to a seven-year low.



Taking the whole picture in reverse, I would say that a persistent refusal by Industrials to penetrate 825.13 and a refusal by Utilities to penetrate 118.96 would constitute the first indications that the market is ready to correct on the upside. But as of this writing, it is far too early to say whether those points are fated to hold.

Again, I want subscribers to remember that this is a primary bear market, a bear who has been held back ever since October, 1966. Bear markets have a habit of raising the hopes of the public, then smashing them mercilessly to smithereens.

I note that the public, as gauged by odd-lot transactions, is still quite hopeful, and this is not a good sign. For instance, odd-lot transactions have stayed pretty much on a ratio of 10 shares purchased for every 7 sold during the past few weeks. On Thursday, July 17, the odd-lotters bought at a very heavy rate of 10 shares purchased for every 6.6 sold or almost 3 to 2 on the buy side. This would suggest that odd-lotters are viewing every rally as a "sure sign that the bottom has been seen." When the true bottom of this leg is actually seen, I would guess that the odd-lot public will be selling both rallies and declines heavily. This simply has not happened to date.

On July 22, despite the success of the moon shot (which by all weekend reports was supposed to inspire the market) the market broke badly with Industrials, Rails and Utilities all at simultaneous new 1969 lows. Rails, in fact, broke below the 200 level for the first time since 1966. In the majority of cases, when all the Averages confirm in the same direction the movement carries for some distance further. As this is written, there is endless talk from Wall Street about a "selling climax," and it is assumed that such an event will provide a final comforting cleanout. Personally, the widespread talk of a selling climax disturbs me.

We might remember that the selling climaxes of 1929 and 1937 were events which were hardly comforting. Occasionally, perhaps once or twice in a generation, there is a selling climax which tears the fabric of the market to shreds. It is possible in the face of the current complacent climax talk that when the selling climax does occur, it will be more climactic than anyone wishes.

RAILS: Since their 1969 all-time high of 279.88 (February 7), the D-J Rails have dropped to a July 15 low of 201.29. This represents a loss of about 29% in a period of five months. There is no question in my mind but that the 29% drop in the price of the Rail Average is reflecting a fundamental change in the earning power of the carriers.

I have included a semi-logarithmic chart (weekly high and low) showing the action of the D-J Rail and Industrial Average (chart marked "A"). Since the chart is drawn to semi-log proportions, the percentages of change in each Average is graphically depicted. On even a glance at the chart, it can be seen that the Rails have been the weaker Average.

There are a number of reasons for the greater Rail weakness. One is that most Rail equities are highly leveraged with debt. Therefore, increasing business or decreasing business will reflect itself in greater changes in Rail profits or losses and therefore greater changes in the price of Rail shares. Furthermore, Rail shares tend to be held by the more sophisticated and more speculative element in the market. These buyers and sellers are likely to move faster and further than the traders in other shares. They are quicker to see trends and quicker to act on a trend. Thus, the Rail Average generally tends to be more subject to greater swings than is true of the Industrial Average.

At present three factors are seen to be weighing adversely on Rail earnings. Higher interest charges on their huge debt structures, high material costs and rising labor costs. One of Wall Street's most astute Rail analysts believes that total net earnings for the Rails in 1969 will run about 14% behind 1968, and he therefore looks for a drop from 1968's \$575 million in final net earnings to about \$500 million in 1969.

I will add that these figures are probably based on current levels of Rail traffic. I would say that any forthcoming decline in Rail traffic brought on by a drop in retail and Industrial sales (which can be translated into Rail carloadings) would play havoc with 1969 and 1970 Rail earnings.

I suggest that subscribers note carefully the trend of the D-J Rail Average. No major Average is more sensitive to the forthcoming fluctuations of business, interest rates, taxes, labor costs and of course volume of business.

So far, on all market rallies the D-J Rail Average has been sluggish or laggard. A continuation of this type of action will, in my opinion, constitute a definite minus for the future of the market and for the future of any market rally. Each day the Wall Street Journal provides percentages of change in the Averages. Watch this listing and note whether

Page 4 the Rails are able to keep up or outperform Industrials on rallies, or whether Rails lose more in terms of percentages when the market declines. I would guess that a continued drop in the relative strength of the Rails will act as a drag on any Industrial attempts to recover.

STOCK STUDIES: So far in 1969, the more speculative stocks have suffered far worse than the majority of quality or blue-chip issues. Nevertheless, it might be instructive to study a few of the price movements in representative N.Y.S.E. issues at this time.

I include a number of monthly charts which serve to show the long-term action of the stocks discussed (charts courtesy of M.C. Horsey, Salisbury, Md. 21801).

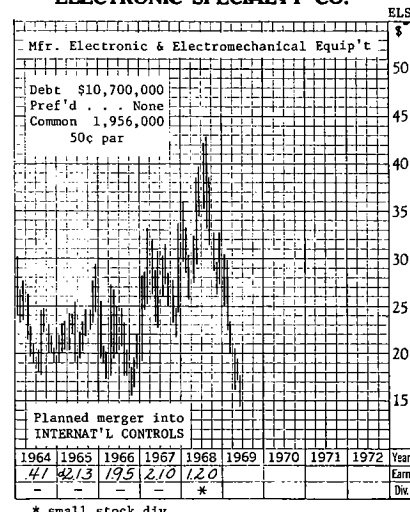
Electronic Specialty is a speculative issue, one which has fluctuated widely over the past few years. But 1969 saw this issue go into a total collapse, thereby wiping out the paper gains of all holders over the past five years. The drastic cave-in from the late-1968 peak of 43 to the recent low at 15 has been fast and furious, actually resulting in a new low for the whole period. Thus all "investors" in ELS are now losing money.

The stock of **Litton** shows a different pattern, typical of the conglomerates and many other issues. The 1966 break corrected the sharp 1964-66 advance in LIT, but during 1967 the stock swept upward, literally doubling in price (figuring from the 1966 low). This dynamic advance, however, proved to be the final distributive rally. LIT broke badly in January, 1968, then participated feebly in the late-1968 advance. The final 1968 rally merely built a "right-shoulder" on what in retrospect was a massive "head-and-shoulders" top. During 1969 LIT fell away, smashing all support back to the 1965 area, and thereby locking in all holders who had participated in the frantic 1966-1969 action. While LIT is now hovering in the area of its 1961 and 1963 peaks, it has provided huge losses for most of its holders.

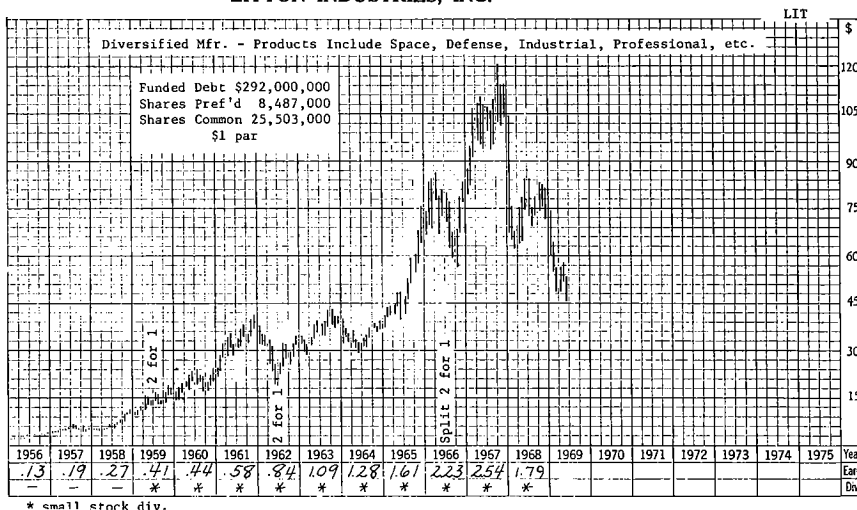
To turn to the quality issues, I have included three representative Dow stocks. Of the 30 Dow Industrials it should be noted that only two touched new record highs during 1969, Goodyear and Woolworth. Four others hit record highs during all of 1968, Kodak, Johns Manville, Owens-Illinois and Westinghouse. Thus, 1968 and 1969 would hardly seem to have been bull market years.

Sears (see chart) was one of the better performing Dow stocks. The 1969 rush took Sears to within a few points of its 1965 historic high. The 1969 downside action did not affect Sears appreciably, so that the stock (so far) can be said to be one of the best acting quality issues. But here is an interesting phenomenon. I have noted that during a true primary bear market, most of the holdouts take it on the chin sooner or later. As the rest of the market drops to lower levels, the holdouts appear to be increasingly "overpriced." Finally, in a rush, the primary trend proves to be the great equalizer. It is then that the hold-outs tumble, if for no other reason than that

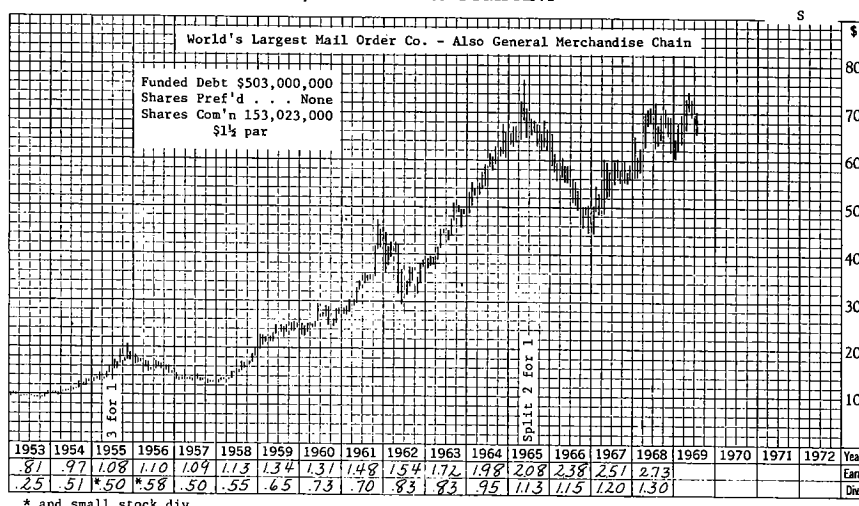
ELECTRONIC SPECIALTY CO.



LITTON INDUSTRIES, INC.

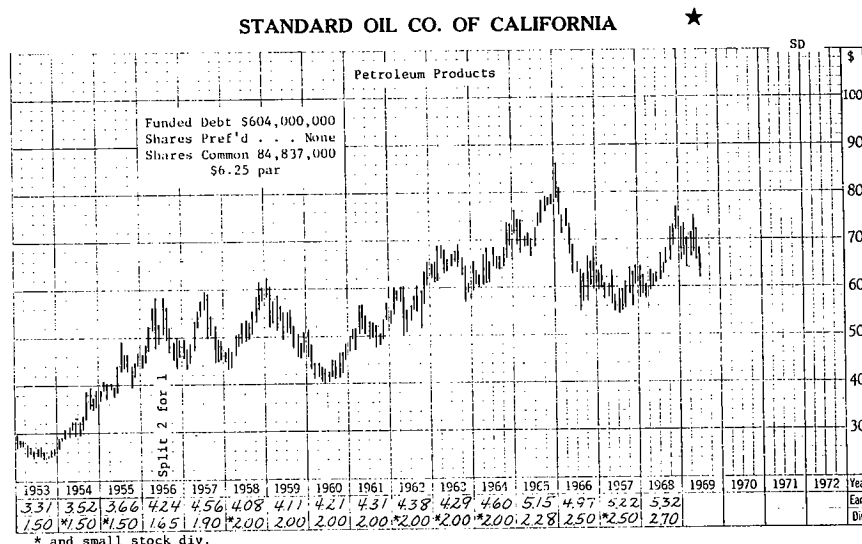


SEARS, ROEBUCK & COMPANY

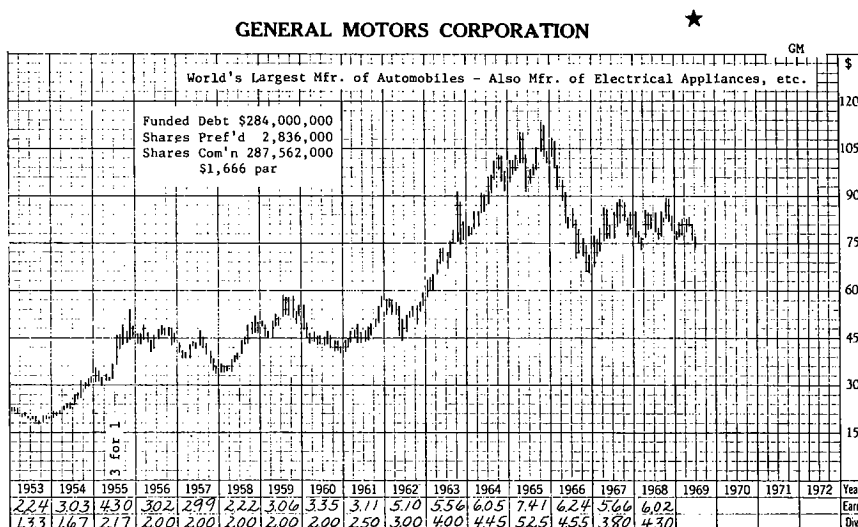


investors want to establish a few profits and the hold-outs are where the remaining profits are.

Standard of California moved in a fairly nice upward sweep from the 1967 lows, but its 1969 peak failed to better the 1968 peak (the 1968 high failing by a wide margin to better the 1966 all-time high). The recent drop in SD, strangely enough, took the stock back to the vicinity of its 1958 peak, its 1963 peak and below its 1963 high. Therefore, upon examination it is clear that SD has made little money for those who have held it steadily over the past 10 years. This suggests distribution or at least discouragement by holders who have passed it back and forth since its 1966 high without ever making any real money on the issue.



Finally, we have mighty GM, a stock which topped out during late-1965. During 1966 GM broke from 113 down to 66, then rallied during 1967 to a peak just under 90. Since 1967 GM has been fluctuating in the 74 to 90 area, and this suggests distribution. The potentially ominous factor about GM is that any further real weakness could take the stock below its 1966 low of around 66. If the 66 level is broken, GM would sink back to its 1963 price range, thus locking in all holders who have held the issue over the past six years.



Personally, I would consider a break by GM below 65 to be about the most bearish thing that any individual stock on the N.Y.S.E. could do. DuPont, the other great Dow stock which I use as a barometer, has already declined to within a few points of its 1957, 1960 and 1962 lows. This is an ominous performance by one of America's great corporations. A break by GM below 66 would be doubly ominous. So far, the formation in GM does suggest distribution to me, and I would watch the 66 level carefully on further marked weakness in this giant motor issue.

ECONOMIC SCRAPBOOK:

July 15..... The House prepares tougher rules for capital gains, including extending the capital gains period to one year. Senate Majority Leader Mansfield predicts surtax will not be voted upon until Sept.
Britain's trade gap on a balance-of-payment basis doubled in June to a deficit of \$67 million. The pound weakened.
GM reports car sales for July 1-10 dropped 25% from last year as the stock sank to a 1969 low.

July 16..... N.Y.C. issues \$146 million in tax-exempt bonds at a cost of 6.15%, the costliest bonds in the history of the City.

S.Africa probably sold all its first half gold production in "special deals" and many of these were thought to be to Central Banks in violation of the ban. Half a billion dollars in gold appeared to be disposed of.

July 17..... Residential housing dropped 4% in June to an annual rate of 1.4 million, but Industrial Production surged to a record 173.9. Thus hopes for a general "slowdown" are frustrated again.

Federal Funds jump to a record 11%, but bankers' acceptances ease slightly to 8.75% bid on the 91-day paper.

A House committee will consider reducing the 27.5% oil depletion allowance.

July 18....Brokerage houses reported to be in severe cost squeeze due to dropping Exchange volume; many sales and operational workers being laid off.

Rail passenger operations said to be in such financial straits that service will end within a few years unless Congress provides relief.

July 22.....Despite tight money, personal income in June jumped to \$745.2 billion over the May figure of \$740.3 billion. A House Committee cleared a proposal cutting the oil depletion allowance from 27.5% to 20%, which would cost oil companies nearly \$400 million.

Mutual fund sales dropped 19% in May while redemptions rose 5% as investors became disillusioned with fund performance during 1969.

A Wall Street Journal survey showed 60 major firms cutting back on new expenditures.

N.Y. State's savings banks lost \$132 million in the first 15 days of July. Higher yielding bonds and bills were blamed.

June 23.....Pres. Nixon states that the "budget picture has worsened," and asks Federal departments and agencies to cut spending by \$3.5 billion.

Car sales for the second 10 days in July dropped 10.7%.

The 91-day Treasury bills hit a record yield high of 7.22%

Moody's Aaa Bond Average hits record yield of 7.09%.

The Cost-of-living index rose another whopping .6% in June.

NOTICE: Again I must thank subscribers for sending me personal letters. Some of these letters post questions, others provide interesting comments and often fascinating information. To answer each of these letters requires work and emotional energy. I simply don't have it, and I must therefore beg off again. It takes as much energy and time to answer a full week's personal letters as it does to write a few pages of this report. I want to give all my energy to the report, and this is the reason I seldom answer correspondence.

So....please do not be insulted, do not feel slighted, do not hate me if I fail to answer your letter. Comments and information are appreciated, questions are studied. If I get a number of questions along the same line I attempt to answer them in the reports. And that's about the story on correspondence. Again, many thank you's and many "I'm sorry for not answering's."

From the "Time for Revisions" Dept. Recently Paine, Webber Jackson & Curtis conducted a poll of 146 of the nation's financial writers regarding where the Dow was heading in 1969. The median forecast put the high for the Dow at 1000. The median forecast put the low for the Dow at 889. Thus, with a median 1969 range of 1000 to 889 for the Dow, it might be said that the nation's writers (in the light of what has happened) were a bit optimistic. So much for the financial writers.

PERSONAL NOTES: To Joe Granville: Hope you're enjoying your European trip, and stay out of trouble. To Harry Schultz: glad to hear you saw Joe in London, and thanks for the invitation to meet you there too. You're right, you couldn't get me out of San Diego with a dynamite stick. To R. Singer of Coral Gables: Hang on to your golds, and I'll try to review some of the Kaffirs coming up. To Henry Howard of Vancouver: Thanks for the terrific letter. I appreciate it. To Jacques Coe in Switzerland: I wish I knew half what you know about Wall Street, and it's always a real pleasure to hear from you. To my old market-genius pal Jay Pack on Wall Street: I still love you even if I never write. I'll take bets you didn't get caught in this decline. You've always had a knack of knowing when to take me seriously.

SAN DIEGO: I moved to La Jolla a year ago. La Jolla is a sort of nothern suburb of San Diego. It is situated on the Pacific and is, in my opinion, the fairest spot in the U.S. (pardon me, Laguna Beach residents). Every time I wax poetic about San Diego a few more subscribers come out here on their vacation, then decide I was right and move here permanently.

San Diego is getting a bit crowded so I won't recommend it any longer. In fact, I would like to ask my subscribers not to move out here too quickly. You might not be ready for the finest climate in the nation, the place with the most in outdoor sports, an area where, within 20 minutes you can be in the mountains, at the sea shore, on the desert, (no, that takes 90 minutes), in Mexico, at any number of University campuses, on Point Loma overlooking one of the world's great harbors or in Carlsbad scrutinizing acres and acres of flaming red poinsettias in one of the world's great horticultural centers.

Other things which might bother subscribers is the low cost of unskilled labor, the reasonable restaurant prices and the preponderance of casual dress. If all that doesn't discourage you, you might object to the cleanliness of this part of the country. They say that "cleanliness is next to Godliness," but I seem to remember that in N.Y.C. cleanliness was next to impossible.